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CARES Act Webinar Series—Opportunities and Potential Pitfalls

Paycheck Protection Program Lessons, Loan Requirements and Funding Risks

APRIL 24, 2020

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Webinar Guidelines

- Participants are in listen-only mode
- Submit questions via the Q&A feature
- Questions will be answered as time permits
- Offering 1 CLE credit in California and New York*
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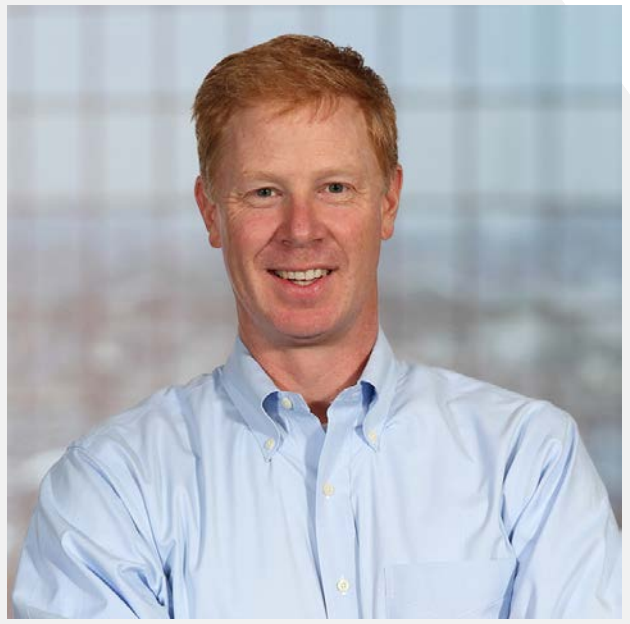

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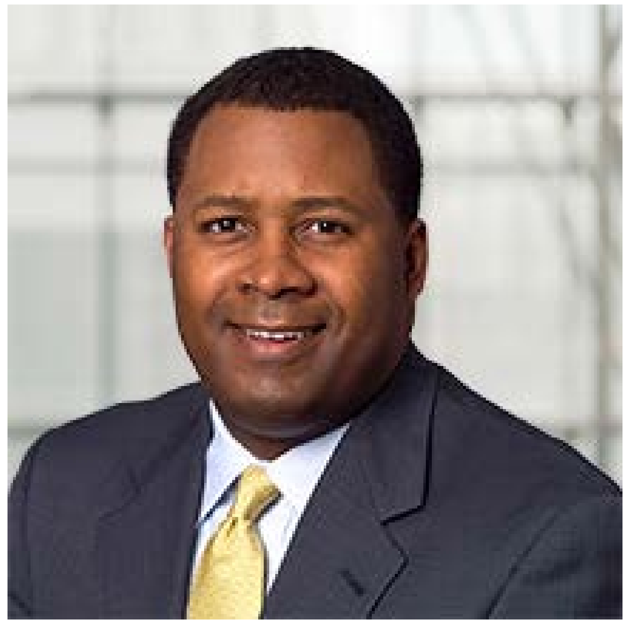

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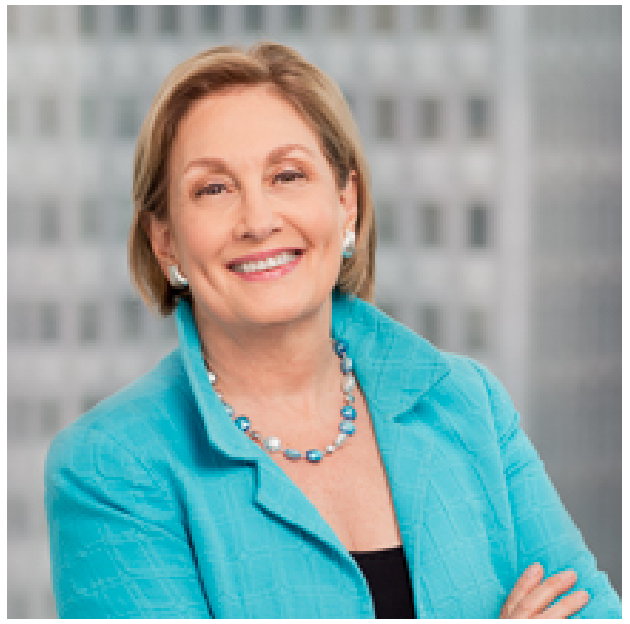

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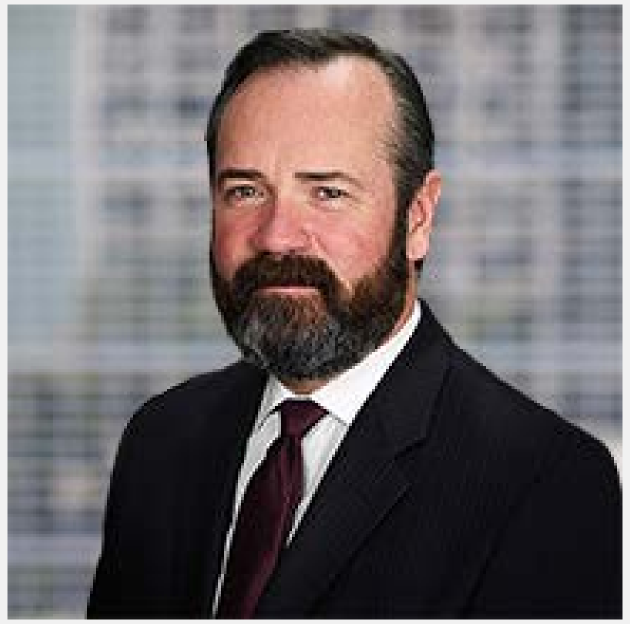

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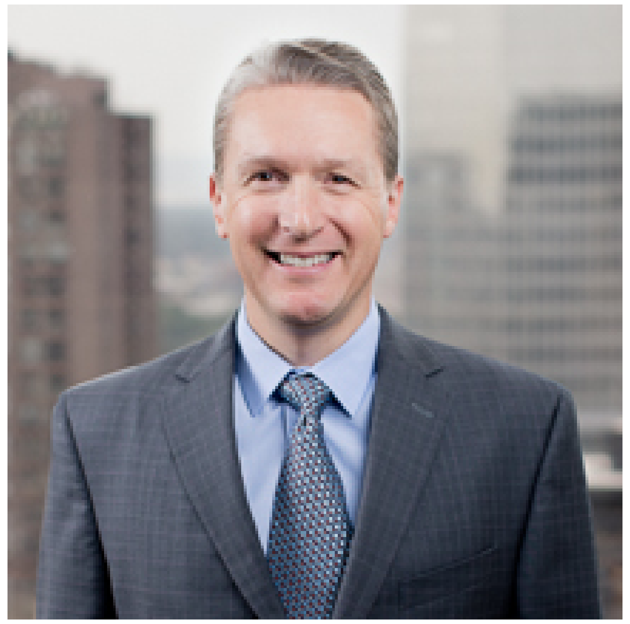

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COVID-19 Stimulus Money: Paycheck Protection Program Opportunities and Pitfalls

— Overview and Status of Paycheck Protection Program (“PPP”)

— Loan Forgiveness

— Best Practices for PPP Borrowers

— Public Reaction and Recent Events

— Congressional Oversight and Regulatory Enforcement

Paycheck Protection Program – Overview

- Part of the CARES Act
- Originally a $349 billion loan program focused on supporting small businesses and businesses in the restaurant and hospitality industry
- Partially forgivable loan at 1% interest for two-year term
- Broad availability to businesses who could certify that "economic uncertainty" makes loan "necessary to support the ongoing operations"
- Maximum loan amount equal to 2.5 times monthly payroll, with cap of $10 million
- Loan to be used for payroll costs, rent, utilities, certain interest payments, but 75% of the loan is to be used for payroll costs
- Forgiveness of portion spent on qualifying expenses in 8-week period after funding
- Restaurant and hospitality businesses in NAICS Code 72 were specifically made eligible if they had more than 500 employees, but fewer than 500 employees per physical location

Paycheck Protection Program – Status

- Submission of applications started on April 10, 2020
- By April 16, 2020, the PPP had been fully allocated, with some approved borrowers still awaiting loan amounts
- In addition to the CARES Act, the Small Business Administration issued three Interim Final Rules, an Affiliation Overview on April 3, 2020 and a series of FAQs starting on April 8, 2020
- The first Interim Final Rule stated that, the "SBA will issue additional guidance on loan forgiveness" and that guidance has not yet been issued
- Legislation is pending appropriating an additional $310 million and setting aside portions of that funding for insured depository institutions, credit unions and community banks

Paycheck Protection Program – Forgiveness

- Some or all of the PPP loan used on eligible expenses during the first 8 weeks will be forgiven
- Amount forgiven will be reduced if:
  - Average FTE headcount during that 8-week period is less than the average FTE headcount during a prior comparison period (borrower can choose either: February 15, 2019 – June 30, 2019 or January 1, 2020 – February 29, 2020) and/or
  - If any wages or salary paid to any employee during the 8-week period (excluding employees with annualized salary of $100,000 or more) is less than 75% of the wages or salary paid to such employee during the most recent fiscal quarter the employee was employed
- Amount forgiven will not be reduced if employees are rehired or wages increased by June 30, 2020

Paycheck Protection Program – Best Practices

- Open a separate bank account
- Develop a good audit trail
  - Understand the rules and use proceeds for a proper PPP purpose
  - Document expenses
  - Track what is/is not forgivable
- Use at least 75% of the PPP loan for payroll costs
- Maximize forgiveness
  - Re-hire employees
  - Assess whether to restore pay cuts
  - Pay attention to the calendar
  - EIDL grants reduce PPP forgiveness amount
- Understand forgiveness versus tax trade-offs

Paycheck Protection Program – Public Reaction and Recent Events

- Recent news reports identified large restaurants, hospitality and other businesses who received PPP funding
- On April 23, 2020, the SBA and Treasury Department issued an update to the April 8, 2020 FAQ providing retroactive guidance on the meaning of the certification contained in the loan application that "economic uncertainty" makes the loan "necessary to support ongoing operations"
- In making this certification, the FAQ directed borrowers to consider their ability to "access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business." The FAQ also noted it is "unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith." Borrowers unable to meet this standard are given until May 7, 2020 to return funding
- Other key certifications required to be made by borrowers are:
  - The borrower is eligible under applicable PPP rules
  - Loan proceeds to be used only for business-related purposes as specified in the loan application and consistent with the program requirements
  - No more than 25% of the forgiven amount may be for non-payroll costs
  - The applicant has not received (nor will it apply for) another PPP loan

Enforcement, Oversight and Reputational Issues

- Historically, recriminations
- Shifting political sands
- Channeling resentments

Venues for Enforcement, Oversight and Reputational Peril

- Enforcement: Civil, Criminal, Federal and State
- Congressional Oversight: Hearings and Inquiries
- The Post-Hoc Review: The 9/11 Commission Model

Paycheck Protection Program – Triggers for Enforcement

- As specified in the applications and guidance documents, PPP requires specific certifications that can expose an applicant to liability if untrue.
- An applicant must make specific representations that, among other things:
  - The Applicant, any owner of the Applicant, or any business owned or controlled by any of them, has never obtained a government loan that is currently delinquent or has defaulted in the last 7 years and caused a loss to the government.
  - The Applicant (if an individual) or any individual owning 20% or more of the equity of the Applicant is not subject to criminal charges are brought in any jurisdiction, or presently incarcerated, or on probation or parole.
  - The United States is the principal place of residence for all employees of the Applicant included in the payroll calculation.
  - The Applicant is not engaged in any activity that is illegal under federal, state or local law.
  - All SBA loan proceeds will be used only for business-related purposes.

<u>False certifications, or failure to maintain certification obligations, can lead to substantial liability</u>.

Potential Sources of PPP-related Liability

- **False Claims Act (“FCA”)**
  - The FCA prohibits false or fraudulent claims, statements, or records companies make or cause others to make that are material to payment of federal funds.
  - FCA violations carry triple damages and penalties of roughly $22,000 per false claim, statement, or record. Intentional violations can bring criminal prosecution.
  - The DOJ prosecutes FCA violations and has historically been active in this area.
- **Financial Institutions Reform, Recovery and Enforcement Act (“FIRREA”)**
  - FIRREA authorizes civil money penalties against persons who violate one or more of 14 enumerated predicate offenses that involve or affect financial institutions and government agencies.
  - FIRREA authorizes penalties of up to $1.1 million per violation, with potential for increase.
  - After a period of dormancy, FIRREA was used aggressively by DOJ in the wake of the financial crisis.
- **Other Civil and Criminal Laws**
  - Potential sources of liability include mail and wire fraud; the Program Fraud Civil Remedies Act; the Racketeer Influenced and Corrupt Organizations Act (RICO); and the Injunctions Against Fraud Act.

Lessons Learned from Financial Crisis Enforcement

- **Heightened scrutiny creates broad legal exposure**
  - Misuse of, or misrepresentations regarding, federal funds create straightforward liability risk. But scrutiny from IGs and others could uncover fraud or other illegal activity unrelated to the company's receipt of federal money, which will could result in collateral investigations and enforcement actions.
- **Enforcement could come quickly and from unexpected directions, including State authorities**
  - Companies receiving federal funds should be prepared for fast-moving investigations and enforcement. The DOJ has already signaled interest in partnering with SBA and using novel data analytic tools to identify and investigate PPP-related fraud. State Attorneys General Offices will also invoke their investigative authorities.
- **Whistleblower complaints are on the horizon**
  - Whistleblowers were a significant source of referrals for DOJ, SEC, and others following the financial crisis.
- **Penalties can be significant**
  - Successful financial crisis enforcement actions—in partnership with DOJ, US Attorneys offices, the SEC, or others—resulted in hefty fines for corporate entities, potential treble damages, jail time for individuals.
- **Take subpoena power seriously**
  - Financial crisis investigators used subpoenas compel production of documents, interviews, and testimony from individuals. These materials were often discoverable and used in subsequent litigations.

Primary CARES Act Oversight Authorities

Special Inspector General for Pandemic Recovery (SIGPR)

- A new Inspector General within the Treasury Department created to provide oversight of Treasury loans and investments and to track and investigate disbursements made under the Act.
- Modeled after the SIGTARP and will have broad investigative authority and subpoena power.

Pandemic Response Accountability Committee

- A new Committee made up of existing Inspectors General with authority to carry out independent investigations, issue and enforce subpoenas, and hold public hearings in connection with funds made available under the CARES Act.

Congressional Oversight Commission

- Newly established Commission, appointed by congressional leadership, will examine decisions made by the Treasury Department and the Federal Reserve and monitor how relief aid is spent.

Comptroller General

- As head of the Government Accountability Office, will monitor, audit, and oversee the use of funds.

Additional CARES Act Oversight Authorities

- In addition to the particular oversight authorities provided for in the CARES Act, Congress will continue to exercise its traditional oversight authority over new funds and programs.
  - A newly formed House Select Committee will oversee the government's coronavirus expenditures.
  - Other standing committees will likely hold hearings and conduct inquiries.
    - The House Oversight & Reform Committee is already actively investigating pandemic response efforts, and the House Financial Services and Small Business Committees have sent letters to regulators and CEOs regarding the implementation of relief programs.

Anticipated Oversight Activity

- **Public Hearings**
  - The Pandemic Response Accountability Committee, the Congressional Oversight Commission, and the House Select Committee are likely to hold hearings regarding their oversight activities.
  - These hearings could include requests for information, subpoenas, and testimony from private individuals and companies.
- **Investigations, Civil Enforcement Actions, & Criminal Charges**
  - The SIGPR can be expected to initiate numerous investigations into the use of CARES Act funds and to work with the Justice Department to hold accountable individuals and institutions that break the law.
  - These investigations, which can extend for years, can result in civil lawsuits and/or criminal charges under the FCA or other statutes.
  - Investigations by other entities, including state agencies, and individual liability are possible.
- **Congressional Scrutiny**
  - Congress will retain jurisdiction over the funds in the relief package.
  - Companies also could receive subpoenas, letters, and requests for information pertaining to their use of relief funds and specific interactions with the members of the Trump Administration.

CARES Act Restrictions

- A key role for oversight authorities will be ensuring compliance with the various restrictions found in the CARES Act, including limitations on executive compensation, workforce reduction, dividend payments, and share buybacks.
- Now is the time for companies to ensure that they are proceeding with due caution as they develop plans related to the CARES Act and other federal coronavirus response efforts.
- This includes ensuring that companies have appropriate policies and procedures around the use of CARES Act payments and the requirements of the Act to receive such payments.

Questions?

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